MAYER • BROWN

Mayer Brown LLP
1999 K Street, N W
Washington, D.C. 20006-1101

Main Tel +1 202 263 3000
Main Fax +1 202 263 3300
www mayerbrown.com

Robert M. Jenkins III
Direct Tel +1 202 263 3261
Direct Fax +1 202 263 5261
rmjenkins@mayerbrown com

RECEIVED
DEC 20
MANAGEMENT
STB

December 20, 2011

BY HAND-DELIVERY

Cynthia Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street. SW
Washington, DC 20423

ENTERED
Office of Proceedings
DEC 20 2011
Part of
Public Record

Re: *Western Coal Traffic League—Petition for Declaratory Order.* STB Finance Docket No. 35506

Dear Ms. Brown:

Enclosed for filing in the above-referenced proceeding are an original and ten copies of the Rebuttal Argument of BNSF Railway Company.

Please date-stamp the enclosed extra copy of the Rebuttal Argument and return it to our representative. Thank you.

Sincerely yours,

Robert M. Jenkins III

RMJ/bs

Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 35506

WESTERN COAL TRAFFIC LEAGUE—
PETITION FOR DECLARATORY ORDER

REBUTTAL ARGUMENT OF BNSF RAILWAY COMPANY

Roger P. Nober
Richard E. Weicher
Jill K. Mulligan
BNSF RAILWAY COMPANY
2500 Lou Menk Drive
Fort Worth, TX 76131

Robert M. Jenkins III
Adrian L. Steel, Jr.
MAYER BROWN LLP
1999 K Street, NW
Washington, DC 20006

Counsel for BNSF Railway Company

Dated: December 20, 2011

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 35506

WESTERN COAL TRAFFIC LEAGUE—
PETITION FOR DECLARATORY ORDER

REBUTTAL ARGUMENT
OF BNSF RAILWAY COMPANY

Pursuant to the decisions of the Surface Transportation Board ("STB" or "Board") served September 28 and December 5, 2011, in the above-captioned proceeding, BNSF Railway Company ("BNSF") files here its rebuttal argument.

Introduction and Summary

The parties' reply filings in this declaratory order proceeding reflect a sharp divergence of views as to how the Board should frame the controlling issue.[1] The shipper interests, who seek to prevent the acquisition cost paid by Berkshire Hathaway, Inc. ("Berkshire") to flow through to BNSF's asset values and URCS costs, frame the issue overwhelmingly as one of fairness. They claim that it is unfair for shippers to have to pay higher rates solely because BNSF was acquired by Berkshire. BNSF, which supports the purchase accounting adjustment, frames the issue as one of adherence to established standards and regulations—is there a persuasive rationale for the Board to depart in this case from the established practice of allowing purchase accounting adjustments to flow through to asset values and URCS costs?

---

[1] Western Coal Traffic League, et al. ("WCTL"), Alliance for Rail Competition, et al. ("ARC"), and Consumers United for Rail Equity ("CURE") filed reply comments in support of WCTL's petition. In addition to BNSF, the Association of American Railroads ("AAR") filed reply comments in opposition to WCTL's petition.

BNSF submits that it would be illogical and arbitrary for the Board to base its decision upon the shippers' formulation of the fairness issue. First, their argument is based on the false premise that it would be unfair for the Board to allow the use of economically accurate asset values and costs for regulatory purposes following the Berkshire acquisition. But if regulatory outcomes in a very limited number of cases are affected by a recognition of more economically accurate asset values and costs, that is not unfair; it is rational and consistent with sound economic regulation. What would be truly unfair—and arbitrary as well—would be for the Board to ignore its rules, reverse 25 years of precedent, and require the use of outdated predecessor costs solely to avoid any impact on shippers.

Second, the shippers' fairness formulation is based on the false premise that the acceptance of the purchase accounting adjustment for regulatory purposes will lead to widespread rate increases. Given BNSF's reliance on demand-based pricing to set rates, there is no reason to believe that any more than a small minority of BNSF's traffic movements would ever be affected by changes in R/VC ratios resulting from the purchase accounting adjustment. Significantly, the Board's core maximum rate standard, the stand-alone cost ("SAC") test, is based on replacement costs for a hypothetical stand-alone railroad—and these stand-alone costs are unrelated to the asset values shown on BNSF's R-1 Report and will be unaffected by the purchase accounting adjustment to BNSF's investment base. The small impact of the purchase accounting adjustment on the jurisdictional threshold is unlikely to have any effect on BNSF's market-based rates.

In contrast to the shippers, BNSF's reliance on established standards and regulations regarding GAAP purchase accounting is grounded in agency and court precedent and sound regulatory policy. Significantly, the shipper interests do not question the soundness of the standards and precedents that BNSF relies on.

Moreover, WCTL confirms in its reply brief that it is not challenging the application of the Board's GAAP purchase accounting rules to the Berkshire/BNSF acquisition, or asking the Board to adopt new rules. WCTL Reply Br. at 7-9, 35-36. It does not challenge the methodology BNSF used to determine the fair value of BNSF's assets as reported in BNSF's R-1 Report for 2010. And it does not claim that the price that Berkshire paid for BNSF was inflated. If, as WCTL and its supporters concede, Berkshire acquired BNSF in a *bona fide* arms-length transaction and BNSF properly established the fair value of its assets under GAAP purchase accounting, the shippers have no legitimate grounds for claiming that the Board should reject acquisition cost and instead use demonstrably outdated predecessor cost valuations to measure BNSF's URCS costs and determine its revenue adequacy.

The shipper parties nevertheless continue to suggest that the Board should ignore the agency's consistent application of GAAP purchase accounting for URCS costing and revenue adequacy purposes, because the agency's rules supposedly were grounded on "merger synergies" in prior transactions. But it is simply not true that "merger synergies" were the foundation of the agency's adoption and consistent use of acquisition cost. Economic accuracy and statutory mandates were and are the overriding reasons for the agency's adherence to GAAP purchase accounting.

In short, the shippers' primary fairness argument is grounded on false premises and their fallback argument for ignoring controlling precedent is unfounded. WCTL's petition should be dismissed.

I. THE USE OF ECONOMICALLY ACCURATE ASSET VALUES AND COSTS IS NOT UNFAIR; IT IS RATIONAL AND CONSISTENT WITH SOUND ECONOMIC REGULATION.

The shippers' primary argument is that it would be "unfair" for the Board to use GAAP purchase accounting to value BNSF's assets for regulatory purposes if use of those asset values would work to the disadvantage of shippers. But the shippers do not dispute that the use of GAAP purchase accounting produces more economically accurate asset values than the use of "predecessor cost" and they do not question the manner in which BNSF applied GAAP accounting to value its assets. The shippers' position is that the Board should ignore the more accurate asset values in favor of inferior and inaccurate asset values simply to avoid any impact on shippers. The shippers' position is untenable. Even if it were true that the use of economically accurate asset values would lead to rate increases, which is not the case, it would be fundamentally irrational to base regulatory decisions on demonstrably inaccurate asset values as an artificial means of keeping rates down.

A. There Is No Dispute That The Use Of GAAP Purchase Accounting Produces More Accurate Asset Values Than The Use Of Predecessor Cost.

The RAPB endorsed GAAP purchase accounting for general purpose costing and revenue adequacy purposes because it was a practicable way to determine a railroad's economically accurate costs. RAPB Final Report. Volume 2—Detailed Report (Sept. 1, 1987) ("RAPB Report"), at 45-47.[2] The ICC adopted GAAP purchase accounting for the same reason. *See Railroad Revenue Adequacy—1988* Determination. 6 I.C.C.2d 933, 935-42 (1990) ("*Revenue Adequacy—1988*"). The ICC determined that it did not matter whether a railroad was purchased

[2] Pertinent sections of the RAPB Report are attached to BNSF's Opening Evidence and Argument for the Board's convenience.

for less or more than its book value. *Id.* at 940. For regulatory purposes, acquisition cost represented the most accurate cost that was practicably available.

The STB made the same determination in *CSX Corp.—Control—Conrail, Inc.*, 3 S.T.B. 196, 261-65 (1998) ("*Conrail*") and Ex Parte No. 582 (Sub-No. 1), *Major Railroad Consolidation Procedures* (served June 11, 2001), slip op. at 28, 2001 WL 648944, *18. It refused to use outdated predecessor cost for URCS costing and revenue adequacy purposes when it had more accurate current costs practicably available. *See also Western Coal Traffic League v. Union Pacific Railroad Co.*, 4 S.T.B. 685, 686-95 (2000) and *FMC Wyoming Corp. and FMC Corp. v. Union Pacific Railroad Co.*, 4 S.T.B. 699, 709 (2000) (reiterating that the Board's Uniform System of Accounts ("USOA") requires railroads to use acquisition cost to report their expenses and net investment to the Board after a merger or acquisition transaction).

WCTL confirms in its reply brief that it is not challenging the validity of GAAP purchase accounting principles or the application of the Board's GAAP purchase accounting rules to the Berkshire/BNSF acquisition, or asking the Board to adopt new rules. WCTL Reply Br. at 7-9, 35-36. WCTL also confirms that it is not challenging the methodology that BNSF, Berkshire, Ernst & Young, and Deloitte and Touche used to establish the fair value of BNSF's assets. *Id.* at 7, 37. *See* BNSF Opening Br. at 14-19, Hund VS at 4-8. Furthermore, WCTL emphasizes that it is "not contending that the transaction price was not *bona fide*, or that Mr. Buffet is attempting to 'game' the system by paying an inflated price for BNSF in the hopes of recovering inflated returns from all of BNSF's customers." WCTL Br. at 38.[3]

In short, WCTL is not challenging the economic validity of BNSF's asset values derived using GAAP purchase accounting. This concession is key. As Chairman Elliott explained in his

[3] ARC and CURE are less clear about their positions, but they also do not ask the Board to adopt new rules, nor do they contend that BNSF did not follow the prescribed fair value methodology.

March 28, 2011 letter to Senator Franken concerning the application of the Board's rules to the Berkshire/BNSF transaction, the objective of the Board's regulations involving GAAP reporting is to ensure that the railroads use the most accurate information about the fair value of their assets in their regulatory reports. Accordingly, Chairman Elliott explained that the Board would take "appropriate action" with respect to BNSF's asset valuations if the Board determined that BNSF's data did not accurately reflect the current value of BNSF's assets. Since the shipper parties do not challenge the accuracy of the data, there is no basis for any corrective action by the Board.

WCTL and the other shipper parties nevertheless claim that the entirety of the purchase accounting adjustment in BNSF's 2010 R-1 Report should be disallowed for URCS costing and revenue adequacy purposes. They fail, however, to demonstrate why it would be permissible under existing precedent or good regulatory policy to single BNSF out for the use of outdated and inaccurate "predecessor cost" data to determine BNSF's URCS costs and assess its revenue adequacy. As the AAR emphasizes in its reply comments, the Board has a clear duty to apply the statutory requirements of 49 U.S.C. §§ 11142, 11161, and 11164, the regulatory requirements of the USOA, and 25 years of settled precedent in a uniform manner to all affected carriers. AAR Reply Br. at 4-6. As we discuss further below, these requirements are equally applicable to BNSF, and the shipper parties have presented no sound basis for the Board to decline to follow them evenhandedly.

B. There Is Nothing "Unfair" About Using Economically Accurate Asset Values In Regulatory Cost Calculations.

Having acknowledged that BNSF appropriately complied with the Board's GAAP purchase accounting rules, the shipper parties nevertheless claim that that does not mean that the Board need use the results of the purchase accounting process to determine BNSF's URCS costs or assess its revenue adequacy. Confronted with the fact that the ICC and the STB have consistently used acquisition cost for precisely those regulatory purposes, they claim that it is "unfair" for BNSF's costs (or, apparently, any other railroad's costs) to be written up for regulatory purposes if shippers may be disadvantaged as a consequence. WCTL Reply Br. at 7-10; ARC Reply Br. at 6; CURE Reply Br. at 8-12. In support of their "unfairness" claim, they assert that failing to remove the purchase accounting adjustment will result in significant increases in shippers' rates. WCTL Reply Br. at 16-22; ARC Reply Br. at 5-6; CURE Reply Br. at 6-7. WCTL asserts that the use of predecessor cost is necessary "to protect the ratepayer and the regulatory framework." *Id.* at 38.

Leaving aside WCTL's misapprehension of the impact the purchase accounting adjustment will have on shippers' rates, which is discussed below, WCTL's assertion is wrong for the simple reason that there is nothing "unfair" about using the most economically accurate data that are practicably available to calculate a railroad's costs and revenue adequacy. On the contrary, what would be both unfair and unlawful would be to use demonstrably inaccurate predecessor cost in order to avoid any impact on shippers. The "regulatory framework" is designed to yield the most accurate costing results that can reasonably be obtained, regardless of which party is favored.

WCTL says that GAAP does not require the use of acquisition cost for regulatory purposes (WCTL Reply Br. at 37), but that misses the point. The point, as the RAPB, the ICC, the STB, and the courts have all emphasized, is that acquisition cost, as implemented by GAAP purchase accounting, more closely approximates a railroad's real economic costs than outdated predecessor cost. *See* BNSF Reply Br. at 25, Weil VS at 3.

The shippers were only too happy to stress this point when railroads were generally being sold for less than book value, and railroads were being disadvantaged by the use of acquisition cost. In fact, shipper groups argued vigorously in *Revenue Adequacy—1988* that the RAPB had properly determined that acquisition cost was the appropriate measure of the railroads' regulatory costs where they were acquired in arms-length transactions, that the ICC should "not switch methodologies simply because they happen to affect revenue adequacy determinations," and that the agency should stick to one method "regardless of the results." 6 I.C.C.2d at 639. The ICC agreed, and concluded that it should use acquisition cost regardless of whether the purchase price of the railroad was above or below the old book value. *Id.* at 640. Shippers supported that decision on appeal, and the D.C. Circuit affirmed. *Assoc. of Amer. RR's v. ICC*, 978 F.2d 737, 741-43 (D.C. Cir. 1992) ("*AAR*").

What would be truly arbitrary would be for the Board to switch valuation methods now because adhering to the settled method might advantage a railroad rather than shippers. The STB recognized this in *Conrail* when it pointed out that shippers had supported "the ICC's decision to follow the recommendation of the [RAPB] to use acquisition cost, not book value, in this precise context." 3 S.T.B. at 262.[4]

WCTL in its reply suggests that circumstances have changed since these ICC and STB decisions, because the Board in recent years has increased its reliance on URCS. WCTL Reply at 23-26. WCTL quotes at length from the Board's 2010 Report to Congress Regarding the

[4] CURE argues that the RAPB Report supported using acquisition cost only when railroads were purchased for less than their book value (CURE Reply Br. at 4-5), but there is nothing in the RAPB Report that says that. The RAPB Report focused particularly on the use of acquisition cost where the market value of a railroad was lower than its book value, because that was the predominant circumstance in the industry in 1987. But the ICC properly recognized in *Revenue Adequacy—1988* and the STB properly recognized in *Conrail* that the acquisition cost principles endorsed by the RAPB were equally applicable to arms-length transactions at prices above as well as below book value.

Uniform Rail Costing System ("URCS Report") about the various ways that URCS is used in rate cases, abandonment proceedings, and trackage rights or line sale compensation proceedings. *Id.* at 24-25. WCTL suggests that the Board's increased reliance on URCS requires rethinking the agency's settled position on acquisition cost. *Id.* at 25-26.

In fact, the Board's URCS Report supports exactly the opposite conclusion. As WCTL itself notes, the Board in its URCS Report emphasized that "[t]he increased reliance on URCS costs should be accompanied by increased vigilance with regard to *continued accuracy*." WCTL at 23 (quoting URCS Report at i) (emphasis added). No one argues in this proceeding that the depreciated book value of BNSF's assets prior to the Berkshire acquisition produced a more accurate estimate of the value of those assets and BNSF's costs than the values established through the post-transaction purchase accounting process. On the contrary, the shippers concede that BNSF's assets were properly valued. As the URCS Report states, it is more important than ever to adhere to more economically accurate acquisition cost for URCS costing purposes, and the post-transaction BNSF URCS costs are clearly more accurate than costs derived from predecessor asset values.[5]

WCTL also claims that although there is no "total circularity" problem in the rail industry with the use of acquisition cost, it is still "fundamentally unfair" to allow purchase accounting

[5] WCTL cites testimony by BNSF in Ex Parte No. 431 (Sub-No. 3), *Review of the Surface Transportation Board's General Costing System (URCS)*, for the proposition that "'[w]ith the Board's increased reliance on URCS costs for regulatory purposes, it is important that the Board ensure that the URCS cost assumptions are accurate and up to date.'" WCTL Reply Br. at 26-27. WCTL's suggestion that BNSF's testimony somehow supports the Board's use of predecessor cost for URCS costing purposes is completely backward. *Id.* at 26. The ICC and the STB have consistently determined that acquisition cost should be used for both URCS costing and revenue adequacy purposes, instead of predecessor cost, precisely because acquisition cost is more accurate and up to date than predecessor cost. *See, e.g., Revenue Adequacy—1988,* 6 I.C.C.2d at 940; *Conrail,* 3 S.T.B. at 262-65; *Major Railroad Consolidation Procedures*, slip op. at 28, 2001 WL 648944, *18.

adjustments "because it requires BNSF customers to pay higher rates for the same service, forces them to pay twice for the same assets, and offers absolutely no offsetting benefits." WCTL Reply at 38. We discuss below the extent to which higher rates may result from BNSF's purchase accounting adjustments. Suffice it to say here that WCTL and the other shippers have grossly exaggerated the impact. But to the extent that regulatory rate ceilings increase somewhat as a result of using more accurate costs, that is not a defect of the regulatory system. Shippers are not entitled to the perpetuation of inaccurate costs simply to suppress regulatory rate ceilings.

Nor is it accurate for WCTL to claim that shippers are forced "to pay twice for the same assets." As we explained at length in BNSF's Reply, BNSF's rates are not set or regulated on an "original cost" basis, and there is no "double-count" involved in the STB's use of the fair value of BNSF's assets for regulatory purposes. BNSF Reply at 19-26, Kolbe/Neels VS at 12-24.[6] Finally, as the STB recognized in *Conrail*, the "offsetting" regulatory benefit of using the fair value of a railroad's assets in this circumstance is that it comports with the statute and good economics. 3 S.T.B. at 264-65. Most importantly, it allows railroads and their investors their Congressionally mandated opportunity to cover "the real value of the property, not just the book value." *Id.* at 265.[7]

---

[6] CURE's assertion that the RAPB determined that "historic costs" must be used with the nominal cost of capital to avoid a "double count" of inflation is misleading. CURE Reply Br. at 4. CURE implies that "historic costs" are confined to "predecessor costs," but the RAPB defined "historical cost" to include *both* acquisition cost and predecessor cost. RAPB Report at 46. Thus, the RAPB sanctioned the use of the nominal cost of capital with acquisition cost (*id.* at 42), and that is exactly how the agency has always made its general purpose costing and revenue adequacy determinations.

[7] CURE and ARC both quote language from the RAPB Report for the proposition that where the ICC determines that GAAP cost is not a meaningful regulatory measure of value, other measures of value may be used. CURE Reply at 4 (citing RAPB Report at 44); ARC Reply at 4 (citing RAPB Report at 39 and 62). There are two fallacies in their suggestion that this means the STB should not use acquisition cost here. The first is that the RAPB, the ICC, and the STB have never been persuaded by the arguments presented in any of their proceedings that acquisition

II. THE SHIPPERS' FAIRNESS FORMULATION IS BASED ON THE FALSE PREMISE THAT THE ACCEPTANCE OF THE PURCHASE ACCOUNTING ADJUSTMENT WILL LEAD TO WIDESPREAD RATE INCREASES.

The shipper parties continue to assert that the use of GAAP purchase accounting will have broad adverse consequences for captive shippers because it will permit the "automatic pass-through of premium-generated rate increases to [BNSF's] captive customers." WCTL Reply Br. at 7-8. The shippers claim that "this case is about fundamental fairness: should captive shipper rates increase – automatically – simply because Berkshire paid an acquisition premium to acquire BNSF. . . ." *Id.* at 7. See also WCTL Reply Br. at 16-22, 26-34; ARC Reply Br. at 5-6, Fauth Reply VS at 7-8; CURE Reply Br. at 6.

The shippers' premise that the use of GAAP purchase accounting will lead to widespread rate increases is completely unfounded. Given BNSF's reliance on demand-based pricing to set rates, there is no reason to believe that any more than a small minority of BNSF's traffic movements would ever be affected by changes in R/VC ratios resulting from the purchase accounting adjustment.

Jurisdictional Threshold. With respect to the jurisdictional threshold, BNSF demonstrated in its opening and reply filings that out of the thousands of shippers and tens of thousands of movements annually on BNSF's system, only a small fraction would see the R/VC ratio for their rates move from marginally above to marginally below the jurisdictional threshold. BNSF Opening Br. at 13-14. The shipper parties present no evidence to the contrary in their

---

cost is not a "meaningful regulatory measure" for general purpose costing and revenue adequacy purposes. The second fallacy is that the agency has always recognized, as Chairman Elliott correctly observed, "that use of acquisition costs for regulatory purposes might not be appropriate if an acquisition price were inflated or depressed by government action or policy." March 28, 2011 Letter from Elliott to Franken. *See* RAPB Report at 46; *Revenue Adequacy—1988*, 6 I.C.C.2d at 939. That is not an issue here, however, since WCTL has conceded that the price paid by Berkshire for BNSF was not inflated (WCTL Reply Br. at 7, 38), and no other party has presented any evidence that shows otherwise.

replies. WCTL Reply Br. at 31; CURE Reply Br. at 3: ARC Reply, Fauth Reply VS at 8. CURE says that no shipper should be deprived of the right to bring a rate case before the Board or to threaten in a negotiation with BNSF to bring such a case. CURE Reply at 3-4. But nothing in the statute or good regulatory policy suggests that URCS costs should be locked into place. regardless of their accuracy, in order to preserve a shipper's ability to bring a rate case. *See Conrail*, 3 S.T.B. at 264.

Moreover, very few rate cases are ever brought. or can be credibly threatened, with respect to rates at or near the jurisdictional threshold. Baranowski/Fisher VS at 6; Lanigan VS at 5-6.[8] CURE's claim that a substantial number of captive shippers may be adversely affected in contract negotiations with BNSF by a modest effective increase in the jurisdictional threshold is completely unsupported. CURE Reply Br. at 4. BNSF did not set its rates before the Berkshire acquisition on the basis of whether the R/VC ratio resulting from such a rate was above or below the jurisdictional threshold, and it does not do so today. Lanigan VS at 5-6.

Rate Reasonableness. There is a significant disconnect between the shipper parties' *assertions* about the impact of the write-up in BNSF's assets on the Board's rate reasonableness calculations and the *evidence* of such impact. WCTL says that BNSF is the "King" of stand-alone cost ("SAC") coal rate cases and quotes BNSF witnesses discussing such cases. WCTL Reply Br. at 17-18, 28-29, 32-34. The shippers' argument appears to be that BNSF's use of

[8] There are but a handful of cases since the implementation of the jurisdictional threshold in the Staggers Rail Act of 1980 ("Staggers Act") where the jurisdictional threshold has acted as a floor on the reasonableness of a rate. One of those handful of cases is *Arizona Electric Power Cooperative, Inc. v. BNSF Railway Co. and Union Pacific Railroad Co.*, Docket No. NOR 42113 (served Nov. 22, 2011) ("*AEPCO*"). The use of more economically accurate BNSF URCS costs will affect the rate prescription in that case. But that is no reason to use demonstrably inaccurate costs to set a rate prescription for AEPCO for the next decade, much less to disallow the purchase accounting adjustments in BNSF's R-1 Report for all other URCS costing and revenue adequacy purposes.

purchase accounting will produce higher maximum reasonable rates under the SAC test. Under the SAC test, however, the STB uses the replacement cost of a hypothetical railroad, not the asset values reported in BNSF's R-1 Report, to assess rate reasonableness. Baranowski/Fisher Reply VS at 6; Kolbe/Neels VS at 13. The results of future SAC analyses will not be affected at all by the purchase accounting adjustment.[9]

WCTL quotes Mr. Lanigan for the proposition that a lot of money can be at stake in coal rate cases, and suggests that this statement acknowledges that a change in regulatory costs will have a substantial effect on BNSF's rates. WCTL Reply Br. at 28-29. WCTL's argument is flawed because it assumes that SAC results will be affected by BNSF's use of purchase accounting. There is no doubt that the stakes in SAC rate cases are often very large. But as explained in BNSF's reply brief and the joint reply verified statement of Messrs. Baranowski and Fisher, the results of a SAC analysis are not affected by the level of URCS variable costs of the movement. BNSF Reply Br. at 16. Baranowski/Fisher Reply VS at 6-8. The amount at stake in SAC cases does not have any bearing on the question whether the application of GAAP accounting will affect BNSF's rates. As to smaller cases brought under the Board's alternative rate reasonableness standards where the stakes by definition are not very large, Messrs. Baranowski/Fisher explained that small changes in URCS variable costs would have only a marginal impact on results.

WCTL also misleadingly claims that Mr. Lanigan has conceded that "BNSF 'has often' adjusted its rates on the basis of regulatory costs" since BNSF has agreed in the past to lower

[9] WCTL continues to make much of the case concerning BNSF's rates to Western Fuels Association and Basin Electric Power Cooperative ("*WFA/Basin*"). But that is a unique circumstance in which rates were prescribed prior to the Berkshire transaction using R/VC ratios. That unique circumstance can and should be addressed in the ongoing *WFA/Basin* proceedings. *See Western Coal Traffic League—Pet. for Dec. Order* (served Dec. 9, 2011), slip op. at 2.

rates in contract negotiations to avoid the costs and risks of rate litigation. WCTL Reply Br. at 17. The costs and risks of litigation are obvious factors that sophisticated parties consider in contract negotiations.[10] The fact that BNSF prefers to reach negotiated settlements of rate disputes if at all possible rather than engage in litigation with its customers says nothing about the possible impact of the purchase accounting adjustment on rates. Since the results of a SAC test do not turn on the URCS costs of a challenged rate and the results of rate reasonableness cases under the Board's alternative standards would be affected only marginally, if at all, by small changes in URCS costs. there is no reason to believe that a shipper's rate negotiating position vis-à-vis BNSF would be affected at all by small changes in regulatory costs that result from the Berkshire acquisition

The shipper parties point once again to the supposed impact of the purchase accounting adjustment on rate cases brought under the Board's small case standards. WCTL Br. at 21: ARC Reply Br. at 6, Fauth Reply VS at 9-10; CURE Reply Br. at 7, 14. But only one such case, a Three Benchmark ("3-B") case, has ever been brought against BNSF. ARC's witness Fauth asserts that it would be "imprudent, irresponsible and a management inefficiency if BNSF failed to look at URCS costs as a benchmark when setting captive rates," especially since the Board adopted new rate reasonableness standards for small cases in 2007 that rely heavily on URCS. Fauth Reply VS at 8. But the 3-B methodology involves a comparison of issue traffic rates to the rates of other comparable movements over the defendant carrier to determine whether the issue traffic rates are out of line with rates on comparable movements. Since the defendants' adjusted URCS costs are applied across the board to issue traffic movements and comparable

---

[10] Mr. Lanigan acknowledged in his reply statement that "[i]n very limited instances. we might look at the R/VC level of a specific rate, such as when a customer calls it to our attention in a negotiation. or the even rarer instances where there appears to be a risk that we might become involved in rate reasonableness litigation." *See* BNSF Reply, Lanigan VS at 6.

movements, the relative level of issue traffic rates (on an R/VC basis) compared to the rates of comparable traffic (on an R/VC basis) would not be affected.

Revenue Adequacy. BNSF showed in its opening and reply filings that it would have been revenue inadequate in 2010 regardless of the purchase accounting adjustments to its investment base. BNSF Reply Br. at 19, Baranowski/Fisher VS at 6-7 and Reply VS at 10-11. ARC's witness Fauth responds by complaining that if BNSF were not excluded from the composite cost of capital calculation for the railroad industry, the result might be different. Fauth Reply VS at 9. Even if that were true, which Fauth does not demonstrate, the Board thoroughly considered and rejected in Ex Parte No. 558 (Sub-No. 14), *Railroad Cost of Capital—2010* (served Oct. 3, 2011), arguments that BNSF should be included in the composite railroad group for determining the railroad cost of capital. Slip op. at 7-8. Moreover, revenue adequacy has never been used by the STB or the ICC to set railroad rates. *Conrail,* 3 S.T.B. at 265. The revenue adequacy calculation does have an impact on the "RSAM" element of the Board's 3-B test, which WCTL and CURE point out. WCTL Reply Br. at 22; CURE Reply Br. at 7. But neither WCTL nor CURE presents any evidence to rebut the demonstration by BNSF's witnesses Baranowski and Fisher, as noted above, that the impact on any 3-B cases that may be brought is modest.

The STB and the ICC have always made clear that both the statutory definition of revenue adequacy and good regulatory policy require them to use the most economically accurate costs that are practicably available to assess a railroad's revenue adequacy. *See, e.g.*, Ex Parte No. 393 (Sub-No. 1), *Standards for Railroad Revenue Adequacy*, 3 I.C.C.2d 261, 276-77 (1986); *Conrail*, 3 S.T.B. at 265. The shipper parties have presented no argument or evidence that could justify substituting outdated and inaccurate predecessor cost for acquisition cost in making revenue adequacy determinations for BNSF or any other railroad.

III. THE SHIPPERS HAVE OFFERED NO VALID BASIS FOR DISREGARDING THE BOARD'S LONGSTANDING PRECEDENT ON THE USE OF GAAP PURCHASE ACCOUNTING

The shippers suggest that the Board's use of GAAP accounting in the USOA is merely a bookkeeping exercise that does not have to be consistently followed in making regulatory decisions. See WCTL Reply Br. at 8, 35-36. As discussed in BNSF's Reply Evidence and Argument (at 27-28), however, Congress in the Staggers Act directed both that the ICC "prescribe[e] expense and revenue accounting and reporting requirements consistent with generally accepted accounting principles" and that it "promulgate such rules pursuant to accounting principles established by the [RAPB]." Staggers Act, 49 U.S.C. § 11166. Following these mandates, the RAPB specifically endorsed the use of GAAP purchase accounting for general purpose costing and revenue adequacy purposes, and the ICC adopted the RAPB's recommendations. *See* RAPB Report at 46-47; *Revenue Adequacy—1988*, 6 I.C.C.2d at 935-42. The STB has consistently adhered to GAAP purchase accounting for regulatory purposes as a matter of law and good economic policy. *Conrail*, 3 S.T.B. at 261-65.

As they have before, the shipper parties continue to claim in their replies that the Board need not follow its consistent practice regarding the use of purchase accounting because prior rail merger and acquisition transactions were different from the Berkshire/BNSF transaction in that the prior transactions involved "merger synergies." WCTL Reply Br. at 8, 36; ARC Reply, Fauth VS at 2-4; CURE Reply Br. at 9. In effect, these parties suggest that the ICC and the STB would not have chosen for the past 25 years to use acquisition cost for URCS costing and revenue adequacy purposes had they not believed that "merger synergies" would erase the effects of the purchase accounting adjustments. As BNSF demonstrated in its Reply Evidence and Argument, the shippers' claim ignores both the economic origin of the acquisition cost principle and its consistent application, regardless of the advantage or disadvantage to railroads or shippers. BNSF Reply Br. at 6-9, 11-12.

The RAPB endorsed acquisition cost in its 1987 Report and the ICC adopted it in *Revenue Adequacy—1988* with nary a word about "merger synergies." Railroads at that point were largely being acquired for less than their book value, but the ICC determined that it should have a uniform policy of using the most economically accurate costs—that is, acquisition cost rather than predecessor cost—regardless of whether a railroad was sold for more or less than its book value. 6 I.C.C.2d at 940. Shippers vigorously supported the ICC's decision (6 I.C.C.2d at 939), which was affirmed on appeal. *AAR*, 978 F.2d at 741-43.

The ICC thereafter applied GAAP purchase accounting in every merger and acquisition transaction involving a Class I railroad—including many transactions where railroads were sold for more than their book value and one, *Blackstone Capital Partners L.P.—Control Exemption—CNW Corporation and Chicago and North Western Transp. Co.*, 5 I.C.C.2d 1015 (1989), where the railroad was acquired by a financial services company. In none of these proceedings was the railroads' use of GAAP purchase accounting even raised as an issue, much less justified on the basis of merger synergies. *See* BNSF Opening Br. at 8-9, 21-22; BNSF Reply Br. at 6-9.

The *only* decision to discuss "merger synergies" was the Board's *Conrail* decision. The Board did discuss the effect that merger synergies were likely to have on the purchase accounting adjustment, but the Board repeatedly made clear that its adherence to acquisition cost was driven by the RAPB's Report, its own rules and precedent, judicial precedent, and the requirements of the statute—none of which had anything to do with merger synergies. *See*

BNSF Reply Br. at 7-8 (quoting relevant portions of *Conrail* decision). The Board's decision was affirmed by the Second Circuit without any reference to merger synergies. *Erie-Niagara Rail Steering Comm. v. STB*, 247 F.3d 437, 442-43 (2d Cir. 2001). Further, the Board the same year in *Major Railroad Consolidation Procedures* reiterated its adherence to acquisition cost without any reliance on merger synergies. Slip op. at 28, 2001 WL 648944, *18.

In short, no one—not the RAPB, not the ICC, not the STB, and not the courts—has grounded its adoption, use, or approval of acquisition cost for general purpose costing and revenue adequacy calculations on "merger synergies." Economic accuracy and the mandates of the statute have always been the core reasons that the agency adhered to GAAP purchase accounting.

The shipper parties also attempt to distinguish prior rail merger and acquisition transactions by claiming that the size of the Berkshire/BNSF purchase accounting adjustment is much greater. WCTL Reply Br. at 9, 36; ARC Reply, Fauth VS at 3, 10. As discussed above, however, they do not claim that BNSF has overstated the fair value of its assets.[11] Nor do they claim that anything in GAAP or the ICC's or STB's decisions in merger or acquisition transactions places a limit on economically accurate asset write-ups or write-downs.

In any event, as a logical and practical matter, the shipper parties are incorrect that the size of the Berkshire/BNSF purchase accounting adjustment is greater than in prior transactions.

[11] Oddly, WCTL accuses BNSF of attempting to "hide the ball" concerning the amount of the purchase accounting write-up. WCTL Br. at 4-5. In fact, BNSF could not have been clearer about the amount of the purchase accounting write-up and how it was derived and allocated. *See* BNSF Opening Br. at 14-19, Hund VS at 4-8; Baranowski/Fisher VS at 2-4. WCTL spends several pages complaining that BNSF's witness Hund emphasized that two-thirds of the premium Berkshire paid over book value, $14 billion, was assigned to "goodwill," which does not affect regulatory costs, and that *all* of the amount that Berkshire paid over BNSF's per share market price was assigned to goodwill, so that no market "premium" is included in BNSF's R-1 costs. WCTL Reply Br. at 11-16 (citing Hund VS at 4, 6). Yet WCTL does not contest the accuracy of Mr. Hund's statements or any of the methods BNSF used to report its costs.

For URCS costing and revenue adequacy purposes, an apples-to-apples comparison of the impact of purchase accounting adjustment depends on the *percentage* increase in the net investment base in the various transactions. *See* BNSF Reply Br. at 9-11; Baranowski/Fisher VS at 3-5. As a percentage of BNSF's old book value, the Berkshire/BNSF purchase accounting adjustment is *less* than in virtually every prior transaction where a railroad was acquired for more than its book value. Baranowski/Fisher VS, Table 3.

Finally, WCTL claims that the Berkshire/BNSF transaction is different because it was not approved by the STB. WCTL Reply Br. at 9, 36. But WCTL nowhere explains why this is relevant. BNSF is still subject to the STB's regulatory jurisdiction, it still has to comply with the STB's GAAP purchase accounting rules, and the STB still has to calculate BNSF's URCS costs and make revenue adequacy determinations for BNSF.[12]

In sum, from the standpoint of applying the Board's purchase accounting rules, there is no difference between the Berkshire/BNSF transaction and prior rail merger and acquisition transactions that could justify using demonstrably inaccurate predecessor cost data to measure BNSF's URCS costs and determine its revenue adequacy.

---

[12] CURE claims that the Berkshire/BNSF transaction is different because Berkshire paid the acquisition premium, not BNSF. CURE Reply Br. at 8-9. This is the same argument that the National Industrial Transportation League ("NITL") and the National Corn Growers Association ("NCGA") made in their opening briefs (NITL Br. at 6; NCGA Br. at 5-6), and it suffers from the same flaws. *See* BNSF Reply Br. at 26. First, the asset values determined in the GAAP purchase accounting process for regulatory purposes are BNSF's asset values; they represent the real values on which BNSF must have the opportunity to earn a competitive return if it is going to continue to attract and retain capital. *Conrail*, 3 S.T.B. at 265. Second, regardless of whether a railroad is acquired by other railroads or by non-railroads, it must provide the same opportunity to investors for a competitive return. *Revenue Adequacy—1988*, 6 I.C.C.2d at 940. Those investors may be the shareholders of a publicly traded railroad or the shareholders of a publicly traded non-railroad like Berkshire. CURE's contention that the Board need have no concern about BNSF's ability to attract and retain capital, because it is no longer a separately traded entity and can rely on Berkshire for funding (CURE Reply Br. at 10-12), is plainly wrong. BNSF must compete just as hard for internally sourced capital as for externally sourced capital.

Conclusion

The RAPB, the ICC, the STB, and the courts have all agreed that GAAP purchase accounting produces more economically accurate costs for regulatory purposes than predecessor cost. There is no debate in this proceeding that the fair values reported by BNSF in its 2010 R-1 Report meet the criteria for economic accuracy under the agency's rules. The shipper parties have failed to demonstrate why as a matter of law and sound regulatory policy the Board should single out the Berkshire/BNSF transaction as an occasion to deviate from its rules and use demonstrably inaccurate predecessor costs to set BNSF's URCS costs and determine its revenue adequacy. WCTL's petition should be dismissed.

Respectfully submitted,

Robert M. Jenkins III
Adrian L. Steel, Jr.
MAYER BROWN LLP
1999 K Street, NW
Washington, DC 20006

Counsel for BNSF Railway Company

Roger P. Nober
Richard E. Weicher
Jill K. Mulligan
BNSF RAILWAY COMPANY
2500 Lou Menk Drive
Fort Worth, TX 76131

Dated: December 20, 2011

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Rebuttal Argument of BNSF Railway Company were served on December 20, 2011, by U.S. mail or hand-delivery on all parties of record.

Robert M. Jenkins III